INITIAL STATEMENT OF REASONS

Home Investment Partnerships Program (HOME)
Title 25, California Code of Regulations

Proposed Amendments to:

Sections 8204, 8207- 8213, 8216 - 8217

INTRODUCTION

This Initial Statement of Reasons (ISOR) has been prepared by the California Department of Housing and Community Development (hereinafter "the Department") to describe amendments to regulations currently in effect for the Home Investment Partnerships (HOME) Program and the factual basis for these amendments.

The State of California receives money from the U.S. Department of Housing and Urban Development (hereinafter "HUD") to make grants to eligible cities and counties (State Recipients) and direct loans to private organizations that qualify as Community Housing Development Organizations (CHDOs). These funds can be used for a wide variety of housing related uses so long as the State, State Recipients and CHDOs comply with a comprehensive set of requirements prescribed by federal law and regulations.

HOME funds are made available to cities, counties, and CHDOs through a Notice of Funding Availability (NOFA) and applications are reviewed, rated, and ranked using various criteria set forth in the State's HOME regulations (regulations).

These regulations can be found at can be found at Title 25, Division 1, Chapter 7, Subchapter 17, Sections 8200-8220. They establish procedures for the award and disbursement of HOME funds, and establish policies and procedures for use of these funds to meet the purposes contained in the federal HOME regulations at 24 CFR Part 92.State authority for the administration of the HOME Program is contained in Health and Safety Code Sections 50406 and 50896.3(b).

DISCUSSION OF PROPOSED AMENDMENTS

Section: 8204. Eligible Applicant

Subsection (a) (1) (D) (iv) This amendment replaces the requirement that State Recipients provide a self-certification of compliance with the submittal requirements of the OMB A-133 Single Audit Report with the stricter requirement that they provide direct evidence of compliance with OMB A-133 submittal requirements. This evidence could be evidence of submittal of the required A-133 report to the State Controller's Office, or evidence that the applicant is not required by OMB rules to submit such audit. The Bureau of State Audits has recently requested that HOME have procedures in place to ensure compliance with the A-133 submittal requirement because some organizations fail to submit an A-133 audit in a timely manner. Requiring direct evidence of submittal rather than just a self-certification will help ensure that we can fulfill our obligations to monitor compliance with this requirement

Subsection (a) (2) (C) (iii) This amendment replaces the requirement that CHDOs provide a self-certification of compliance with the submittal requirements of the OMB A-133 Single Audit Report with the stricter requirement that they provide direct evidence of compliance with OMB A-133 submittal requirements. This evidence could be evidence of submittal of the required A-133 report to the State Controller's Office, or evidence that the applicant is not required by OMB rules to submit such audit. The Bureau of State Audits has recently requested that HOME have procedures in place to ensure compliance with the A-133 submittal requirement because some organizations fail to submit an A-133 audit in a timely manner. Requiring direct evidence of submittal rather than just a self-certification will help ensure that we can fulfill our obligations to monitor compliance with this requirement

Section: 8207. Amount of HOME Assistance

Subsection (a) (2) (B) (i) This subsection currently permits first-time homebuyer primary lender loans to have terms not exceeding 30 years. The proposed amendment would require these loans to have a minimum term of at least 30 years. Though a 30-year home mortgage is still very common, because of the rising costs of housing over the last several years, an increasing number of primary lenders are finding it necessary to offer loan terms greater than 30-years in order to make the monthly mortgage payment more affordable. This change will enable HOME loans to be made in conjunction with these new loan products, providing further affordability to homebuyers. The language in this subsection permitting loan terms of 33 and 38 years for RHS loans has been deleted since these terms are at least 30 years.

Pursuant to subsection (ii), the primary lender loan must still be fully amortizing and have a fixed interest rate that does not exceed the current market rate. Loans which create a "payment shock" for the homebuyer, such as interest-only loans, are still not permitted.

Section: 8207.1 Homebuyer Education Requirements

Currently, HOME has no requirement that first-time homebuyers receive homebuyer education. However, HOME's sister state program, CalHome requires that homebuyer education be provided to all homebuyers receiving its funds for mortgage assistance. Because homebuyer education serves to help the first-time homebuyer prepare for and maintain homeownership, it is important that it be provided to the homebuyers served with HOME funds. While the Department is sensitive to the fact that there are fewer resources available in rural areas for homebuyer education, the curriculum is basic enough that the information can be provided fairly easily. HOME is also available to assist jurisdictions in locating this information.

The requirements of this section mirror those of the CalHome program. The homebuyer education curriculum shall be pre-approved by the Department and at a minimum, shall include the following topics; (1) preparing for homeownership; (2) available financing and credit analysis; (3) loan closing and homebuyer responsibilities; (4) home maintenance and loan servicing. These topics were selected by CalHome after researching homebuyer education programs including: USDA-Rural Development's Homebuyer's Educational Program; Fannie Mae's "Guide to Homeownership"; a copy of the curriculum used by Self-Help Enterprises, a large provider of self-help housing in California; printed material from Consumer Credit Counseling Service of Sacramento Valley a recipient of HUD funding for homebuyer counseling; and discussions with the Housing Authority of Fresno, which provides extensive homeownership classes.

Funds for providing homebuyer education will be available through the regular activity delivery amounts available for first-time homebuyer programs and projects.

<u>Section</u>: 8208. Affordability Requirements

<u>Subsection (b)</u>

BACKGROUND: Federal HOME regulations at 24 CFR 92.252 establish rent ceilings, requiring that rents not exceed the lesser of the HUD Fair Market Rent or 30% of the adjusted income of a family whose annual income equals 65% of the area median income (AMI) (the High HOME Rent). For projects with five or more units, at least 20% of the units must be rented to very low income families (those earning not more than 50% AMI) at rent levels which do not exceed 30% of the adjusted income of a family whose annual income equals 50% AMI (the Low HOME rent), or 30% of the household's adjusted income.

In addition to High and Low HOME rents, for projects that receive federal or state project-based rental subsidies, federal HOME regulations permit the total rent to be the rent allowable under the project-based subsidy program – which may be more or less than that permitted under the High or Low HOME rents.

For sponsors and lenders attempting to underwrite a rental project, it is extremely important to be able to accurately project cash flow that will be available to pay debt service and operating costs. For this reason, government funding programs establish controlled rents based on percentages of AMI, rather establishing rents based on a percentage of a family's income, which may change over time and differs from family to family. However, the consequence of setting rent ceilings based on income bands is that a family that earns less than 65% of AMI, and very low income families earning less than 50% of AMI, are required to pay more than 30% of their income for rent. Another outcome of setting rents based on income bands is that sponsors are prone to rent as many units as possible at the High HOME rents to generate greater cash flow.

The State has been attempting to address this issue through competitive rating factors. For example, the State's 4% bond program provides additional rating points to projects which propose to serve greater percentages of people with incomes at 60% and 50% AMI and below. The Department's MHP program also provides additional points and financing to projects that achieve rents at or below designated low rent levels ranging from 40% AMI down to 20% AMI.

Finally, most HOME rental projects receive funding from a variety of public funding sources. Frequently, these funding sources require rents lower than the HUD maximums. As a consequence, HOME-funded units often are subject to more restrictive rent caps than the HUD maximums due to another lender's requirements. Often, these more restrictive rents are reflected in the application for HOME funds.

PROBLEM: Pursuant to the current HOME regulations, when the Department prepares the regulatory agreement that will govern the project, the required rents are set forth in a table listing High HOME rents and Low HOME rents. As noted above, these may or may not be the actual rents that will be charged to tenants depending on the requirements of other lenders, or the receipt of federal project-based subsidies. This becomes confusing for Department staff when projects are monitored in the field. Moreover, pursuant to Section 8212.2, with the deep targeting proposed in these regulations, the Department proposes to reduce rents below the federal rent caps for certain projects in exchange for a deeper public subsidy. The purpose of subsection (b) is to make clear that rent levels that will govern a project, and be memorialized in the regulatory agreement, will be the lesser of the applicable High or Low HOME rents or another rent level approved by the Department. This approved rent level will generally be that which the applicant proposes in its application in order to meet the rent restrictions of its other financing sources.

Pursuant to this subsection, the Department may also approve rents at levels higher than those normally required by 92.252 or another financing source, if such rent levels are permitted by a rental subsidy source such as HUD Section 8, or if such rent levels are necessary to preserve the fiscal integrity of the project where fiscal integrity has been jeopardized due to factors that could not reasonably be foreseen. The flexibility provided by this provision is needed to comply with other regulations governing rental subsidies or to help ensure that projects remain financially feasible over time so that they can continue to operate. This flexibility is consistent with the Department's Multifamily Housing Program (MHP) regulations.

<u>Section</u>: 8209. Tenant-Based Rental Assistance

Pursuant to Section 8204, a city may only apply for funding for activities within its incorporated boundaries, and a county may only apply for funding for activities within its unincorporated boundaries. Currently, Section 8209 of the regulations permits State Recipients to request permission from the Department if they want to provide tenant-based rental assistance (TBRA) outside of the jurisdiction to which these funds were awarded. The proposed amendment permits a State Recipient to provide TBRA funds to assist tenants who wish to reside in another HOME-eligible jurisdiction within the county of the jurisdiction to which those funds were awarded.

For a variety of reasons including but not limited to low vacancy rates, extremely high rents, lack of disabled access, unit size, or the need to access public transportation, tenants may want to reside in units located in other HOME-eligible areas. Providing this flexibility will increase the number of units potentially available for use with TBRA. However, the use of TBRA funds outside of the county of the original jurisdiction will not be permitted because this makes administration of the funds more difficult, including determining payment standards, developing relationships with local landlords willing to accept TBRA, monitoring use of the funds, and inspection of units.

<u>Section</u>: 8210. Application Process

<u>Subsection (d)</u> This subsection discusses what information shall be specified in the Notice of Funding Availability (NOFA). The proposed amendment clarifies that the Department must specify in the NOFA the particular activities eligible under that NOFA. This clarification is necessary in instances where the Department issues a NOFA under which funds for all activities are not available, such as an over-the counter NOFA, as permitted by subsection (g) or Section 8212.1 (b).

<u>Section</u>: 8211. Application Requirements/Form

<u>Subsection (e) (4)</u>

(i) (A) This subsection currently requires applicants proposing project activities to submit information in their application adequate to determine the feasibility of the proposed project, including information adequate to determine financial feasibility under the UMRs. The proposed amendments clarify that projects must also submit information adequate to determine compliance with other State and federal HOME requirements, and that UMR compliance is required only of rental projects, not first-time homebuyer projects, since the UMRs do not apply to first-time homebuyer projects pursuant to Section 8212.2 of the HOME regulations. (The exception to this is the UMR standard for demonstrating site control, which HOME has previously chosen to apply to first-time homebuyer projects pursuant to Section 8212).

(i) (B) This new subsection requires rental new construction project applicants to submit a market study, property appraisal, and Phase I/Phase II environmental site assessments as requested by the Department. For rental rehabilitation and /or acquisition projects, lead-based paint, asbestos, and mold assessments must be submitted rather than Phase I/Phase II reports.

Market studies are necessary to demonstrate that there is sufficient demand for the project's residential units at the proposed rents, as well as sufficient demand for any proposed commercial uses. Sometimes it is not clear whether there are enough people in the market area of a proposed project who are willing or able to pay the proposed rents, whether people are willing to commute to and from the project to job centers, or if commercial space within the project will generate enough income to support the project if needed. Market studies are needed to answer these types of questions before the Department must decide whether to invest in a project.

Property appraisals are necessary to establish the market value of the project's land and buildings. This is particularly important if HOME funds will be used to acquire the property, particularly if there are use restrictions or other unique aspects of the property that should affect its sales price and the amount of funds HOME provides for acquisition.

Phase I and Phase II Environmental Site Assessments are commonly used by developers and lenders with new construction projects to assess past and present land use practices and site operations and conditions in order to identify the potential presence of hazardous substances and soil and/or groundwater contamination at or near the site, and assess the impact of this contamination on the site and its potential inhabitants. A Phase II report will typically not be necessary if the Phase I report conclusively demonstrates that there are no Recognized Environmental Conditions on or near the site.

Phase I and Phase II reports are not typically done for rehabilitation projects since the project has already been built; however rehabilitation activities can uncover the presence of lead-based paint hazards in buildings constructed before 1978, or mold or asbestos hazards. The Department must be made aware of these problems when evaluating a proposed project to determine if remediation of these problems is feasible, if the developer has adequately budgeted for the remediation, or if remediation can be done in time to meet the project completion deadline.

(ii) (A) As currently required for first-time homebuyer programs pursuant to Section 8211(a) (5), first-time homebuyer projects must now submit guidelines that will tell the Department how the project plans to administer its funds in compliance with State and federal HOME requirements. The guidelines address issues such as eligibility and income qualification, amount of HOME subsidy provided per household, maximum purchase price limits, flood insurance, affirmative marketing and/or fair housing, and procedures for ensuring that the units remain owner occupied for the period of affordability. Although first-time homebuyer project applicants have never been required to submit guidelines, requiring submission of guidelines addressing these issues will help to foster awareness of and compliance with these requirements.

(ii) (B) Similar to rental project applicants, applicants for first-time homebuyer projects must submit a market survey, property appraisal, and Phase I/Phase II report if the project involves new construction, or lead-based paint, asbestos, and mold reports if the project involves rehabilitation. Market surveys are used in the homebuyer market to determine what an acceptable home sales price might be based on the recent sales of similar homes in the area. The market survey should also give the Department an indication of the demand for the proposed homes in the market area of the project. Property appraisals, Phase I & Phase II Environmental Site Assessments, and lead, asbestos, and mold reports are used in much the same way in evaluating the feasibility of first-time homebuyer projects, as they are used in evaluating the feasibility of rental projects.

All of the documents requested in (i) and (ii) must be prepared by independent third parties having no identity of interest with the applicant, the partners of the applicant, the intended partners of the applicant, or with the general contractor. The individual or firm that prepares the report must possess the appropriate license or knowledge and experience to prepare the subject reports, and use recognized methods and techniques necessary to produce a credible and complete report. Each analysis, opinion, and conclusion must also be communicated in a manner that is not misleading as to the true market needs for affordable housing, and the value and condition of the property. Similar requirements have been adopted by the MHP program pursuant to Section 7309 of its regulations.

Section: 8212. Application Selection and Evaluation

Subsection (b)

This subsection addresses the general criteria used to rate applications for funding as well as the general process for ranking applications. This section currently requires that applications for programs and projects be rated and ranked separately. Language has been added to clarify that applications for rental projects and first-time homebuyer projects will also be rated and ranked separately. Rental projects and first-time homebuyer projects cannot be scored or ranked together primarily because most of the financial feasibility criteria for rental projects are underwriting requirements of the Department's UMRs. These requirements were developed only to apply to multifamily rental housing, not single family home ownership.

Subsection (b) (4)

Currently this section awards up to fifty points to applications which address one or more State Objectives that have been identified by HOME in the Department's Annual or Consolidated Plan submitted to HUD. Once identified in the Annual or Consolidated Plan, the public, including potential applicants for HOME funds, has the opportunity to submit comments on the proposed State Objectives. The Department, in turn, must consider and respond to these comments.

HOME would like to increase the maximum number of points awarded for meeting State Objectives from 50 to 150. This will enable the Department to divide the number of available points among several different State Objectives. In 2006, fifty State Objective points were awarded to rental projects which proposed more affordable rents. In the future, the Department may want to establish State Objectives that are not specific to rental projects, but that can also be met by program or first-time homebuyer applicants, such as performance incentives, or incentives to encourage energy efficiency in new construction or rehabilitation activities. Increasing the number of points available in the State Objectives rating category will give the Department the flexibility to provide more ways to get State Objective points, or to weight State Objectives differently. Increasing State Objective points to a maximum of 150, will increase the current maximum possible score to 1100 points for program applicants, and 1700 points for project applicants, with State Objective points constituting a maximum of 15% of the rating score for programs, and a maximum of 10% of the score for projects.

Subsection (d)(1) (A)

Currently, this subsection addresses deduction of rating points based on the performance of the applicant in prior HOME contracts. Up to 200 points are deducted for the following: missed project deadlines (up to 200 points), late submittal of required annual, quarterly, or project completion reports (up to 50 points), and noncompliance with monitoring requirements (up to 100 points). Missed project deadlines are set forth in Section 8217, and include: (i) obtaining all necessary permanent financing, (ii) project set-up in IDIS, (iii) construction loan closing, (iv) project completion, and (v) expenditure of all funds.

No changes are proposed in the total number of points to be deducted for each of the prior performance rating factors; however, proposed changes would permit the Department to look at the performance of the developer, owner, and managing general partner by permitting deduction of points if in the most recent five-year period as specified in the NOFA any of these entities: (i) was involved in a project that missed a HOME project deadline, or (ii) made a material misrepresentation of any requirement or fact in an application, project report, or other document submitted to the Department which jeopardizes the Department's investment in the project or puts the Department at risk of receiving a monitoring finding. (iii) Applicants, owners, and managing general partners who have not complied with monitoring requirements identified by the Department in the last five years would also have points deducted on the HOME project applications in which they are involved.

For example, if Developer A was involved in Project (1) and that project missed a project deadline pursuant to Section 8217, the applications for projects (2) (3) and (4) in which Developer A is also involved in will receive deductions based on the Developer's performance in Project (1). Likewise if an application is submitted with a managing general partner that has not complied with monitoring requirements involving other projects identified by the Department in the last five years, that application will receive a points deduction based on the managing general partner's noncompliance with these monitoring requirements.

Currently, HOME applicants receive up to 200 points based on the prior experience of the applicant, developer, owner, or managing general partner in developing other projects similar to the proposed project. The proposed amendments account for the past poor performance of the applicant, developer, owner, or managing general partner. It is important for the Department to examine both sides of this coin when awarding points based on the capability of the project team. The project developer, owner(s) and managing general partner(s) typically work closely together during the development of a project. Owners and managing general partners also have an ongoing responsibility for the successful operation of a project. All of these entities share responsibility for the performance of a project, not just the applicant for HOME funds. The HOME rating system needs to account for the past poor performance of these entities to reward entities that are performing well, and to have some measure of accountability over those that are not. HUD has ranked California's State HOME near the bottom compared to other state HOME programs in its commitment and expenditure rates. Implementing measures to motivate developers, owners, and managing general partners to meet HOME project deadlines is necessary to improve future performance.

Deductions under this section can also occur if the applicant, developer, owner, or managing general has in the most recent five-year period as defined in the NOFA made a material misrepresentation of any requirement or fact in an application, project report, or other document submitted to the Department, including but not limited to that which jeopardizes the Department's investment in a project or places the Department at risk of a monitoring finding. An example of when points might be deducted under this section is if an applicant continually underreports the amount of Program Income it has on hand, and this amount, if it had been spent as required would have made the applicant ineligible to receive a

HOME loan in an amount which it has received. The Department needs the ability to deduct application rating points for these types of problems to motivate applicants to take care to comply with HOME requirements, and to reduce the number of incidences that cause problems for the Department.

In addition to the above changes, the regulations clarify that deductions for late or missed reports will only be based on the performance of the applicant since the applicant has the primary responsibility managing the administrative functions associated with the HOME contract. Proposed changes also add the monthly status report for projects to the list of reports for which project applications could receive point deductions if not submitted in a timely manner as proposed in Section 8216 (discussed below).

Monthly status reports capture the developer's progress with the project, and the status of compliance with key federal and state requirements, including prevailing wage and environmental assessment. Providing incentives to submit monthly status reports will help the Department capture more data on project progress so that it can better evaluate what obstacles to project performance exist, and how to improve its administration of HOME funds.

<u>Subsection (d) (3)</u>

This subsection was added to discuss feasibility rating factors for first-time homebuyer projects. The regulations currently require all projects to be evaluated for feasibility based on compliance with the UMRs; however, the UMRs only apply to multifamily rental projects, not single-family homeownership. Instead, the Department will evaluate the feasibility of homebuyer projects by looking at whether the project meets federal and state HOME requirements. This includes, an evaluation of the adequacy and cost-reasonableness of the proposed development budget, the demonstrated market for the project, including both the assisted units and the non-assisted units, if any, and the affordability of the project, taking into account other available financing to the homeowner, and HOME income requirements

HOME funds can only be used for eligible costs that are reasonable and necessary to provide affordable housing. The Department will evaluate the budget for adequacy and reasonableness based on its general knowledge of costs for similar projects in that region. Pursuant to 24 CFR 92.250, it will make sure that the project complies with HUD's per-unit subsidy limits, and invests no more HOME funds than is necessary, in combination with other governmental assistance, to provide affordable housing. It will also make sure that the project adequately budgets for necessary costs such as environmental remediation or relocation.

The Department will also evaluate whether there is sufficient demand for the project's units at the proposed sales prices. This is necessary to ensure that the units can be sold to eligible low or very-low income households, and all HOME funds can be expended by the State's contract expenditure deadline. In order to make this determination, HOME will look at sales data for similar homes in the region. HOME will also look at the needs and income levels of the target market, and the proposed sources of financing to make the homes affordable to low-income households. In addition, HOME will examine whether proposed sales prices for any non-assisted units in the project are feasible. If the non-assisted units cannot be easily sold, this jeopardizes the financial viability of the project, and may impact the affordability of the assisted units

<u>Section</u>: 8212.1. Allocation by Type of Activity and Rural Location

Currently, this section requires that HOME funds be split into an allocation for programs and an allocation for projects based on the actual application demand for programs and projects in response to the initial NOFA of a funding cycle. Proposed amendments to this section would do the following: (1) create separate allocations for rental projects, and first-time homebuyer projects; (2) establish a minimum allocation for first-time homebuyer projects of 5%; (3) clarify that the current minimum allocation for program and rental project activities is 40%; (4) clarify that program, rental project, and first-time homebuyer project applications will be rated and ranked separately from one another, and (5) permit over-the counter funds for program activities to be divided equally among all applicants requesting these funds.

Currently, the regulations provide for two separate allocations between programs and projects, and require that programs and projects be rated separately from one another. A separate allocation for rental projects and first-time homebuyer projects is proposed because rental projects are subject to stricter underwriting standards, pursuant to the UMRs than are first-time homebuyer projects, necessitating that that the two project types be rated separately. Without the same rating system, it is unfair to rank and fund these projects out of the same allocation.

Currently the minimum allocation for programs and projects is 40%. With three separate allocations, it is mathematically impossible for all three to receive at least 40% of the available funds; hence, a minimum allocation of 5% is proposed for first-time homebuyer projects. In the last three years, actual demand for first-time homebuyer project funds has not exceeded an average of 5%. (See table below.) With a 5% minimum allocation, the Department anticipates that it will fund an minimum of two first-time homebuyer projects per year, assuming average available funds of $60 million annually. At this minimum allocation level, the number of first-time homebuyer projects that will receive funding will also remain fairly consistent with prior years.

Year	2004	2005	2006	3-Year Average
Percentage of HOME funds awarded to first-time homebuyer projects	3%	9%	4%	**5%**
Number of applicants requesting first time homebuyer project funds that received them	2 of 2	8 of 9	1 of 2	**80%**

With a separate allocation for first-time homebuyers, the proposed language clarifies that the minimum 40% allocation now in the regulations will apply to program and rental project activities.

Currently, the regulations provide that if any minimum allocation is undersubscribed for applications submitted under the initial NOFA, the remaining funds may be made available under a subsequent NOFA on a first-come first served basis. Pursuant to this subsection, for the past two years, the Department has made some funds available for program activities on an "over-the counter" (OTC) first-come-first served basis. Proposed amendments would give the Department the ability to make funds available for program activities under a subsequent NOFA to all eligible applicants who apply by dividing the available funds equally among all eligible applicants.

The purpose of the OTC NOFA for programs has been to give programs that were ineligible to apply under the initial NOFA because they did not meet the 50% expenditure rule, (Section 8204(b)), a chance to apply for funds once they reached the 50% expenditure level. These additional funds were intended to help jurisdictions operate their programs year-round without interruption in funding. Demand for OTC funds will change from year to year. Factors such as rising housing prices, the incentive to reach the 50% expenditure level, and an increase in new applicants for program funds may cause more jurisdictions to reach the 50% expenditure level sooner than anticipated, creating more demand for OTC program funds. Hence, the Department would like the flexibility to be able to divide available OTC program funds equally among all eligible applicants if in any given year there is more demand for OTC funds than funds available. This will enable all eligible applicants to receive some funds to keep them going until the next NOFA.

Section: 8212.2. Deep Targeting

It is the desire of the Department to induce the production of more rental units at rents below the Low HOME rent ceilings. The proposed regulations would provide additional funds to reduce a project's private mandatory debt so that it pays less in interest or other related expenses and can use this savings to provide lower rents. (For an expanded discussion of the benefits of deeper targeting see the discussion under Section 8208.)

Subsection (a) defines deep targeting funds as additional funds awarded to rental projects to provide rents below the 50% AMI rent level as set forth in the NOFA. The 50% rent level was chosen because this is the typical Low HOME rent.

Subsection (b) is necessary to give the Department the authority to offer funds above the regular HOME maximum loan amount for deep targeting.

Subsection (c) Although the Department generally desires to reduce rents through increased public subsidy, it is not possible to determine the depth of public subsidy necessary to achieve a specified reduced rent in advance because there are too many variables. For example, construction costs and operating expenses have increased over the last decade much faster than anticipated. Furthermore, it is not known what the demand will be for deep targeting funds, or the amount of deep targeting funds that will be made available in any particular NOFA due to changes in the annual HOME allocation. Therefore, this subsection is necessary to give the Department the flexibility to establish the desired reduced rent level as of the date a NOFA is released.

Subsection (d) Existing HOME regulations impose a 55-year affordability requirement for newly constructed rental projects and existing rental projects that are being acquired and rehabilitated. Rental projects that only receive funds for rehabilitation are required to maintain affordability for 20 years. The purpose of this section is to ensure that all projects receiving deep targeting funds will have affordability controls in place for a minimum of 55 years. Because of the deeper public subsidy provided under deep targeting, the Department wants to achieve a longer-term public benefit.

Subsection (e) Rental projects proposing use of nine percent Low Income Housing Tax Credits, and rental rehabilitation projects that are not requesting funds for acquisition shall not be eligible to receive DT funds. Nine percent projects already receive more debt-free financing through tax credits than do other projects. Since the nine-percent tax credit competition is highly competitive, HOME is also hesitant to commit additional dollars to these projects before it is known whether they will receive tax credit financing. If projects need additional HOME funds to be competitive in the nine percent competition, this issue may be addressed through the NOFA by adjusting the maximum loan amount available to these projects. This does not need to be addressed through the deep targeting regulations. Rental rehabilitation projects that are not requesting funds for acquisition are also ineligible to apply for deep targeting funds because, pursuant to Section 8208, these projects are not required to have a 55-year affordability period. Deep targeting projects must have a 55-year affordability period as discussed above.

Subsection (f) sets forth the criteria upon which deep targeted projects will be evaluated. Projects must rank high enough in the general competition for HOME dollars to receive deep targeting funds. If the project does not otherwise rate high enough to receive general HOME funds, it should not receive deep targeting funds. If more projects request deep targeting funds than there are funds available for this purpose, projects will be evaluated for deep targeting funds based on: (i) the percentage of total HOME units restricted at or below the deep targeting rent levels set forth in the NOFA; and (ii) the average rent, expressed as a percentage of area median income for all units in the project.

(i): The percentage of total HOME units at or below deep targeting rent levels will give more points to projects with deeper rents, which is the primary policy goal of deep targeting. For this rating factor, only HOME units will be evaluated so that HOME can regulate all units receiving points here, and monitor these rent levels in the future to ensure that the deeply targeted rents are being maintained.

(ii): The average rent, expressed as a percentage of area median income for all units in the project will give more points to projects with lower average rents. For this rating factor, all units will be evaluated, not just the HOME units. This deep targeting rating factor is proposed because the Department realizes that some units will need to be above the deep targeting rent level to make the project financially feasible. Aside from financial feasibility reasons, it is also good public policy for projects to serve a mix of income levels.

If a project does not score high enough on the deep targeting rating factors to receive deep targeting funds, the project will be rated at the regular maximum HOME loan amount. Hence, a project will not be thrown out of the HOME competition if it does not receive deep targeting funds. To throw an application out that did not receive deep targeting funds would be unfair since there is less money available for deep targeting than for HOME activities in general. It would also discourage people from applying for these funds, and in doing so fewer projects would be deeply targeted.

Subsection (g) requires applicants requesting funds for deep targeting to submit two sets of financial documents as requested in the application. This is necessary so that: (1) if the project does not receive deep targeting funds it can be evaluated at the regular maximum HOME loan amount, as discussed above; and (2) the Department can evaluate whether mandatory debt and rents will be lowered if deep targeting funds are provided. The Department will also use this information to evaluate other financing issues that may be different because of the addition of deep targeting funds, such as reduced financing commitments from private lenders, or reduced HOME match. Except for differences attributable to reduced non-public agency debt, the two project scenarios must be the same. This is necessary to ensure that deep targeting funds are being used to reduce private debt to provide lower rents, and not to supplement some other portion of the project budget.

Project rent levels must change because of the addition of deep targeting funds. The project's unit mix, (number of one-bedroom units, number of two-bedroom units, etc.), may change in order to accommodate lower rents; however, the total number of units in the project may not change. Deep targeting can not cause a reduction in the number of units provided by the project. Permitting a reduction in the number of affordable housing units in a project would be contrary to Department goals to provide additional funds to increase the supply of affordable housing.

Among the HOME-assisted units, no more than four different rent levels expressed as a percentage of area median income shall be used for each bedroom size. While HOME encourages the development of projects designed to serve a mix of household sizes and income levels; HOME does not want to make monitoring compliance with rent and income restrictions so difficult that the restrictions, and the protections provided by them, become meaningless because the appropriate monitoring is not feasible.

Subsection (h) addresses how available deep targeting funds will be divided between urban and rural communities. Generally speaking, projects in rural areas cannot lower rents as much as projects in urban areas because incomes and rents in rural areas are already lower. For example, in 2006, the HUD median income level for a family of four in Butte County was $50,800, and the HUD median rent was $1,320. By contrast, the HUD median income level for a family of four in Santa Cruz County was $78,500, and the HUD median rent was $2,040. To avoid unfair comparisons on deep targeting rating factors among counties with very different income levels, the Department will make fifty percent of deep targeting funds available to counties with HOME income limits lower than the median income limit identified in the NOFA, and fifty percent of the funds available to counties with HOME income limits higher than the median income limit identified in the NOFA. Unallocated funds from one group will be made available to the other group. Since the HOME income limits are adjusted annually by HUD, it is necessary to examine the income limits annually before setting the median income level in the NOFA that will serve to divide the counties into two groups.

Section: 8213. Conditional Reservation of Funds

Amendments to this section have been made to clarify that since programs, rental projects, and first-time homebuyer projects will have separate allocations pursuant to Section 8212.1, conditional reservations of funds for these applications will be made in the order in which these applications are ranked within their respective allocations.

<u>Section</u>: 8216. Reporting and Recordkeeping

A new subsection has been added to require recipients of project funds to submit a monthly project status report. The report must be submitted no later than ten days following the last day of the month. For projects currently under construction, the monthly project status report must include a monthly labor compliance certification. The monthly status report shall continue to be submitted until the final project completion report is accepted in the federal disbursement and information system (IDIS).

The purpose of this report is to capture the developer's progress with the project, and the status of compliance with key federal and state requirements, including prevailing wage, and environmental assessment. The State HOME program currently ranks in the bottom third of all states in overall performance. Providing incentives to submit monthly status reports will help the Department better evaluate what obstacles to project performance exist, and how to improve its administration of HOME funds.

<u>Section:</u> 8217. Project Deadlines

The section has been amended to be consistent with changes made in Section 8212(d) (1) (A) discussed above whereby current project applications will receive performance penalties for missed deadlines on past projects involving the current project applicant, developer, owner, or managing general partner.

Consistent with the current waiver provision for applicants/HOME contractors, subsection (c) has been amended to permit these performance penalties to be waived if it is determined in the Department's sole discretion that the missed project deadline was clearly outside of the control of the applicant, developer, owner, or managing general partner.

Subsections (b) and (c) have been re-lettered to correct previous errors in the lettering of these paragraphs.